OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
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May 19, 2008

Members of the Montgomery County Council

I am pleased to present to you the Quarterly Report of the Montgomery County Employees' Retirement System ("ERS") for the quarter ended March 31, 2008. This quarterly report is designed to assist you in understanding the current status of the ERS. This report was prepared pursuant to the provisions of the Montgomery County Code.

History

The Employees' Retirement System was established in 1965 as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of Montgomery County and other agencies or political subdivisions who elect to participate. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. There were an estimated 5,250 active members and 5,110 retirees participating in the ERS as of March 31, 2008.

Performance Results

The total return achieved by the ERS assets for the quarter was a loss of 4.08%, 154 basis points ahead of the 5.62% loss recorded by the policy benchmark. For the one year period ending March 31, 2008 the estimated ERS' gross return (before fees) was 2.48%, 89 basis points ahead of the 1.59% return of the policy benchmark. The one-year return places the ERS' performance in the top 30% of a universe of public pension funds constructed by the Board's consultant, Wilshire Associates. For the three-year period, our annualized performance was 9.03%, before fees, ranking in the top 11% of the universe. The asset allocation at March 31, 2008 was: Domestic Equities 35.1%, International Equities 20.7%, Fixed Income 24.4%, Inflation Linked Bonds 11.7%, Private Equity 5.1%, Real Estate 2.8% and Cash 0.2%. We estimate that the funded status of the ERS was 82.2% as of March 31, 2008, an increase of 0.3% from 81.9% at December 31, 2007. The actual funded status will be affected by the ERS' membership experience, as well as demographic and economic changes and may be higher or lower when calculated by the actuary during the next valuation.

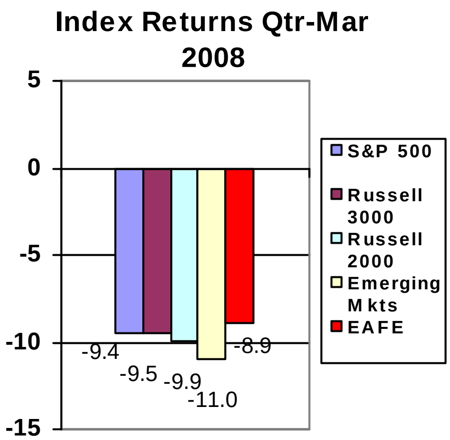
Major Initiatives

During the quarter, the Board continued to implement the revised asset allocation strategy by approving the selection of two hedge-fund-of-funds and a beta replication manager to provide diversified absolute return strategies and index replication. The implementation of new investment strategies and managers will take place over the next 18 to 24 months. In addition, the Board established a Compliance and Audit Committee tasked with the oversight and reporting of issues related to disclosure, compliance, and conflicts of interest.

Capital Markets and Economic Conditions

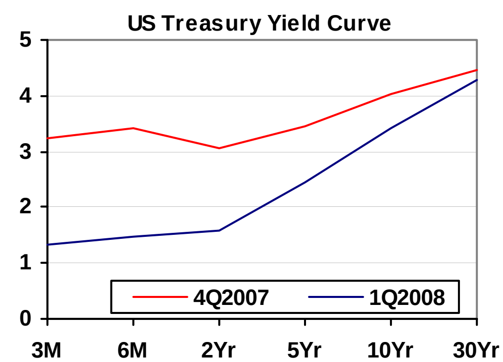
During the quarter financial markets saw increased volatility due to the ongoing negative economic news and issues related to the credit crisis. Labor markets were significantly softer during first quarter with non-farm payroll down on average 77,000 per month. The housing sector continued to decline precipitously and consumer sentiment, which has valiantly supported the US economy over the last several months, has started to fade. Global growth remains strong, particularly in the emerging markets and the Far East which have lower costs and strong demand.

The Federal Reserve has continued its easing policy, cutting the Fed Funds rate by 200 basis points during the quarter in an attempt to provide liquidity to the financial system. They were perceived by some to be a little slow reacting but their action has been sharp and decisive to avert a financial banking collapse. They have maintained liquidity in the marketplace not just by aggressively lowering rates but also by conducting auctions of Treasuries to large investment firms and providing non-traditional lending opportunities to the banking system to help strained credit markets. The market came to the brink of meltdown during the quarter with the collapse of Bear Stearns, but the crisis was, at least temporarily averted through intervention by the Fed and JP Morgan. There is potentially some further good news coming from the weakening of the US dollar. Exports have been increasing and with low inventory-to-sales ratios, the industrial sector appears to be on a decent footing.



U.S. equity markets declined across the board due to further weakening of the housing sector and concerns over consumer spending. As shown in the chart to the left, large capitalization companies (as represented by the S&P 500 Index) outperformed their smaller counterparts (Russell 2000 Index) for the quarter. Value stocks outperformed growth stocks across the capitalization spectrum. The top performing sectors of the S&P 500 during the quarter were consumer staples, materials, and industrials, while IT, telecom, and financials were the worst performing sectors. Our combined domestic equity performance was a loss of 9.4%, 12 basis points ahead of the Russell 3000 benchmark return. For the one year period ending March 31, our combined domestic equity portfolio recorded a loss of 5.56%, 50 basis points better than the benchmark's loss of 6.06%.

Within the international equity sector, developed markets, as measured by the MSCI EAFE Index, were down 8.91% for the quarter compared to emerging markets which fell 10.99%. Among the EAFE markets Hong Kong (-18.89%) and Greece (-15.83%) detracted the most from returns. The markets of Turkey (-38.38%), India (-26.99%), and China (-23.69%) led the underperformance within the emerging markets sector. Our combined international equity performance was a loss of 7.87% (6.47% after including the performance of our currency managers) for the quarter, 128 basis points ahead of the benchmark loss of 9.15%. For the one year period ending March 31, our combined international equity returned 3.57% (5.63% after including the currency managers), outperforming the benchmark by 142 basis points.



Ongoing economic weakness and financial market crisis has continued to put pressure on fixed income markets. Liquidity has been limited in spread products, such as corporate bonds and mortgage/asset backed securities, resulting in a negative impact on pricing relative to Treasuries. CMBS, ABS and high yield bonds were all down 6-8% for the quarter versus Treasuries causing yields to continue to tighten and the yield curve to steepen. At the end of March, the yield on 2-year Treasuries was down almost 1.5% for the quarter to 1.58% and 10-year Treasuries declined by over 0.5% to 3.41%. Combined fixed income performance for the quarter was a loss of 0.95%, trailing the 0.76% gain recorded by the benchmark index. Our global inflation-linked bond portfolio, combined with the portable alpha overlay, recorded exceptionally strong returns for the quarter, up 7.96%, almost 4% ahead of the benchmark's return of 4.08%. Opportunistic allocations to commodities, Japanese bonds and currency positions versus the dollar were all accretive towards performance.

The private equity sector saw buyout activity slowing in the wake of reduced liquidity, while the venture capital sector of the market has been relatively unaffected to date. Distressed debt investors are preparing for opportunities that may arise if economic weakness continues. Commercial real estate property-level fundamentals remain strong, though the aggressive financing utilized by some investors in recent years may precipitate a decline in prices as short-term loans come due. During the first quarter, our private equity managers called a combined $9.2 million of capital for our investments across their funds and paid distributions of $3.0 million. Our current allocation to private equity is 5.1%, with a market value of $134.1 million. During the quarter, there were capital calls from our real estate managers totaling $7.0 million and distributions of $0.4 million. Our current allocation to real estate is 2.8%, with a market value of $72.5 million.

Additions

The primary sources of additions for the ERS include member and employer contributions and investment income. The following tables show the source and amount of additions for the quarter ending March 31, 2008 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 3/31/2008	Fiscal YTD
Employer Contributions	$ 29.3	$ 88.2
Member Contributions	4.5	14.1
Net Investment Income (Loss)	(114.1)	(76.3)
	$ (80.3)	$ 26.0

Deductions

The deductions from the Employees' Retirement System include the payment of retiree and survivor benefits, participant refunds, and administrative expenses.

Employees' Retirement System
Deductions by Type (millions)

	Qtr 3/31/2008	Fiscal YTD
Benefits	$ 36.8	$ 109.9
Refunds	0.2	0.5
Administrative Expenses	1.0	2.0
	$ 38.0	$ 112.4

Outlook

There is a sense that the worst of the de-leveraging has occurred, however, there may still be surprises and further economic and financial concerns to confront. It is still too early to tell whether the Fed's recent actions will be enough to produce lower borrowing rates for businesses and consumers in the future. Interest rates being charged to consumers and businesses are not much lower than they were in August making it difficult for either group to spend especially when they are faced with higher oil and other commodity prices and falling asset values.

As we work through this high and unusual period of volatility, we are reminded that each asset class has its own characteristics that react differently in various environments. Over recent quarters, the overall Plan performance has been somewhat protected by its allocation to global inflation-protected securities which returned 12% so far this fiscal year. This is in sharp contrast to the recent negative performance of our public equity portfolios, although public equities enjoyed a strong run during the last few years when the economy was much stronger.

Our approach to managing investment risk is to diversify the Plan's asset allocation across a number of different asset classes, as well as allocating assets to skilled investment managers who can add value independent of market direction. This combination of strategic asset allocation, as well as dedicated active management, will help us manage our exposure to market volatility and meet the long-term targets of the retirement system.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
March 31, 2008

Assets		
Equity in pooled cash and investments	$	413,454
Investments:		
Northern Trust		2,612,497,933
Aetna		12,372,914
Fidelity - Elected Officals Plan		1,002,087
Total investments		2,625,872,934
Contributions receivable		5,853,798
Total assets		2,632,140,186
Liabilities		
Benefits payable and other liabilities		4,256,774
Net assets held in trust for pension benefits	**$**	**2,627,883,412**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
March 31, 2008

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 29,304,995	$ 88,226,092
Member	4,451,457	14,148,574
Total contributions	33,756,452	102,374,666
Investment income (loss)	(111,350,531)	(67,596,067)
Less investment expenses	2,686,726	8,743,526
Net investment income (loss)	(114,037,257)	(76,339,593)
Total additions	(80,280,805)	26,035,073
Deductions		
Retiree benefits	26,254,897	79,010,585
Disability benefits	8,805,109	25,854,606
Survivor benefits	1,686,622	5,031,831
Refunds	147,806	493,374
Administrative expenses	1,035,942	2,028,924
Total deductions	37,930,376	112,419,320
Net increase (decrease)	**(118,211,181)**	**(86,384,247)**
Net asset held in trust for pension benefits		
Beginning of period	**2,746,094,593**	**2,714,267,659**
End of period	**$ 2,627,883,412**	**$ 2,627,883,412**